

Rev. Proc. 2006-31

SECTION 1. PURPOSE

This revenue procedure provides guidance concerning the factors that must be present in order for a taxpayer to receive consent to revoke an election previously filed under § 83(b) of the Internal Revenue Code. It also sets out procedures for submitting a request for consent to revoke a valid § 83(b) election.

SECTION 2. BACKGROUND

.01 Under § 83(a), if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, then the excess of the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) as of the first day that the transferee's rights in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over the amount (if any) paid for the property is included in the service provider's gross income for the taxable year which includes that day.

.02 Section 83(b) and § 1.83-2(a) of the Income Tax Regulations permit the service provider to elect to include in gross income the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any lapse restriction, as defined in § 1.83-3(i)) over the amount (if any) paid for the property, as compensation for services. If this election is made, the substantial vesting rules of § 83(a) and the regulations thereunder do not apply to the property, and, assuming there is no compensatory cancellation of a nonlapse restriction, any subsequent appreciation in the value of the property is not taxable as compensation to the service provider.

.03 Under § 83(b)(2), an election made under § 83(b) must be made in accordance with the regulations thereunder and must be filed with the Internal Revenue Service no later than 30 days after the date that

the property is transferred to the service provider.

.04 Section 83(b)(2) and § 1.83-2(f) provide that an election under § 83(b) may not be revoked without the consent of the Commissioner. The regulations also provide that such consent will only be granted where the person filing the election is under a mistake of fact as to the underlying transaction and must be requested within 60 days of the date on which the mistake of fact first became known to the person who made the election. Neither a mistake as to the value (or decline in the value) of the property for which the election was made nor the failure of anyone to perform an act that was contemplated at the time of transfer of the property constitute a mistake of fact for this purpose.

.05 The mistake of fact exception in § 1.83-2(f) is narrow in its scope. A mistake of fact is an unconscious ignorance of a fact that is material to the transaction. See 27A AmJur 2d, Equity § 10. By contrast, a mistake of law occurs where a person is ignorant of, or comes to an erroneous conclusion as to, the legal effect of the facts. See 27A AmJur 2d, Equity § 15.

.06 The failure of a service provider to understand the substantial risk of forfeiture associated with the transferred property is not a mistake of fact under § 1.83-2(f).

.07 The failure of a service provider to understand the tax consequences of making an election under § 83(b) is not a mistake of fact under § 1.83-2(f).

.08 The Internal Revenue Service has recognized the principle that an election made under the Code or regulations may be revoked on or before the due date for making the election. See Rev. Rul. 56-67, 1956-1 C.B. 437, dist. by Rev. Rul. 76-393, 1976-2 C.B. 255. See also Rev. Rul. 78-295, 1978-2 C.B. 165. Accordingly, a request for consent to revoke a § 83(b) election will generally be granted if the request is filed on or before the due date for making that § 83(b) election.

.09 If consent to revoke an election under § 83(b) is granted, it will be effective as of the date of the § 83(b) election.

SECTION 3. SCOPE

This revenue procedure applies to taxpayers who wish to revoke a valid election under § 83(b).

SECTION 4. PROCEDURE

.01 A request for consent to revoke an election made under § 83(b) must be made under the procedures for requesting a letter ruling. See Rev. Proc. 2006-1, 2006-1 I.R.B. 1, or its successor.

.02 In addition to a complete description of the facts and the other information and documents required under section 7.01 of Rev. Proc. 2006-1, or its successor, the request must contain: the date the § 83(b) election was made; a copy of the § 83(b) election; a description of the mistake of fact as to the underlying transaction; and the date on which the mistake of fact first became known to the person making the election.

.03 If the request to revoke an election under § 83(b) is being made on or before the due date for making the election, this fact must be included in the request for revocation.

SECTION 5. EXAMPLES

Example 1. On July 10, 2006, in connection with the performance of services, Company M transfers 100 shares of substantially nonvested Company M stock to A, its employee. The restricted stock agreement provides that the stock will revert to Company M if A's employment is terminated for any reason before July 10, 2010. A pays \$50X for the shares, which have an aggregate fair market value of \$100X on July 10, 2006. On that same day, A files a valid election under § 83(b). On July 28, 2006, A learns that the forfeiture provision in the stock agreement means A will forfeit the stock even if Company M terminates A's employment without cause. In addition, A realizes that A misunderstood the tax results of filing the election. On August 16, 2006, A files a request for a ruling from the Internal Revenue Service for consent to revoke A's § 83(b) election. The request cites A's misunderstanding of the forfeiture provision and A's misunderstanding of the tax results as the basis for the ruling request. While A's request for a ruling is made within 60 days of the date A learns the full meaning of the forfeiture provision and when A realizes the tax results of filing the election, neither reason for which A requests the revocation is a "mistake of fact as to the underlying transaction." The underlying transaction is A's receipt of the restricted stock transferred pursuant to the employment agreement. A's misunderstanding of the forfeiture provision is not a mistake of fact as to the underlying transaction. Rather, it is a failure to understand the substantial risk of forfeiture set forth in the restricted stock agreement. Additionally, A's misunderstanding of the tax results of the election is a mistake of law and not a mistake of fact. Accordingly, consent to revoke the § 83(b) election will not be granted.

Example 2. The facts are the same as in *Example 1*, except that the request for a ruling is filed on August 4, 2006. Because the request is filed within the 30-day period during which the § 83(b) election

could be made, consent to revoke the § 83(b) election will be granted, regardless of the reason for which it is filed.

Example 3. On August 31, 2006, B begins employment with Company O under an employment contract that provides that B will receive Company O Class A common stock. On September 1, 2006, Company O transfers 50X shares of substantially nonvested Company O Class B common stock to B in accordance with the employment contract. B pays \$100X for the shares, which have an aggregate fair market value of \$100X on that date. On September 15, 2006, B makes a valid election under § 83(b) with respect to the stock transfer. On September 29, 2006, B discovers that Company O has two classes of common stock and that Company O transferred Class B common stock to B instead of Class A common stock. On November 1, 2006, B files a request for a ruling from the Internal Revenue Service to revoke the election. B's request for consent to revoke the § 83(b) election is timely, and it is based on a mistake of fact as to the underlying transaction because B did not receive the property B expected to receive in the transfer. Based on these facts, and absent any other facts to the contrary, consent to revoke the § 83(b) election will be granted because the stock B received was transferred under a mistake of fact as to the underlying transaction.

Example 4. The facts are the same as in *Example 3*, except that B files the request for the ruling on December 15, 2006. Because the request for revocation was not requested within 60 days of the date B discovered the mistake of fact as to the underlying transaction, B's request will not be granted.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective June 13, 2006.

SECTION 7. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545-2018.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collection of information in this revenue procedure is in section 4. This information is required to evaluate and process the request for consent to revoke the § 83(b) election. The collection of information is required to obtain a letter ruling granting consent to revoke the § 83(b) election. The likely respondents are individuals.

The estimated annual reporting and/or recordkeeping burden is 400 hours.

The estimated annual burden per respondent/recordkeeper varies from 1 to 4 hours.

The estimated number of respondents is 200.

The estimated annual frequency of response is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax return and tax return information are confidential, as required by § 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jean Casey of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure, contact Jean Casey at (202) 622-6030 (not a toll-free call).